Recent Trends in Franchise Injunctions

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INTRODUCTION

Injunctions play a key role in franchising. They enable franchisors to enforce in-term and post-term covenants contained in their franchising agreements to protect their brand, reputation and franchise system generally. They also allow franchisees to enjoin franchisors from wrongfully terminating their franchise relationship pending trial.

Where a franchisor seeks to enjoin a franchisee from breach of a restrictive covenant or a franchisee seeks to enjoin a franchisor from wrongfully terminating their relationship at an interlocutory stage, courts have generally followed a well-established formula or three-part test (the "Three-part Test").[2] First, is there a serious issue to be tried? Second, will the moving party sufferable irreparable harm if the injunction is not granted? Finally, does the balance of convenience lie in favour of granting the injunction?

Although interlocutory injunctions to enjoin a breach of a negative covenant or termination of a franchise relationship are not granted automatically,[3] and non-competition covenants are never presumed to be enforceable, where the facts of the case satisfy the Three-part Test, courts have typically granted an interlocutory injunction without applying a great deal of scrutiny to the case's merits.

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[2] The quintessential three-part test for an interlocutory injunction is set out in *R.J.R MacDonald Inc. v. Canada* (A.G.), [1994] 1 S.C.R. 31 at pp. 334 – 343.

[3] Justice Robert J. Sharpe, *Injunctions and Specific Performance*, 2nd ed., looseleaf (Aurora: Canada Law Book, 1992 -).

Recent trends, however, indicate that there is some judicial debate regarding how to approach and apply the Three-part Test. In particular, there is a dichotomy as to whether the first part of the Three-part Test should be "serious issue to be tried" or the more stringent requirement of "strong *prima facie* case". In addition, where a franchisor seeks to enjoin a franchisee from breach of a non-competition covenant, courts are now requiring more concrete evidence of irreparable harm, rather than merely accepting that such breaches generally harm the franchise system. Thirdly, even where there is a clear breach of a restrictive covenant by a franchisee, courts increasingly require plaintiff franchisors to satisfy all three elements of the Three-part Test as opposed to only the first part of the Three-part Test. Indeed, Ontario courts appear to be looking more closely at the merits of a case at the interlocutory stage, and, as a result, it appears to becoming more difficult for franchisors to obtain an interlocutory injunction in Ontario courts. On the other hand, where franchisees seek to enjoin a franchisor from terminating a franchise agreement, courts continue to apply the lower threshold serious issue test and do not appear to apply the same degree of scrutiny.

FIRST TREND: THE THRESHOLD: FROM "SERIOUS ISSUE TO BE TRIED" TO "STRONG *PRIMA FACIE* CASE"

Traditionally, under the first part of the Three-part Test, courts have applied the threshold of "serious issue to be tried" in determining whether to grant an interlocutory injunction to enforce a restrictive covenant contained in a franchise agreement, such as a non-competition covenant. Indeed, the "serious issue" threshold has been applied by courts in the majority of franchise cases since the Three-part Test was articulated by the Supreme Court of Canada in *R.J.R. MacDonald Inc. v. Canada* ("*R.J.R. MacDonald*").[4] The "serious issue" threshold has generally been considered to be a relatively low one to meet and requires the judge hearing the injunction to be satisfied, based only on a preliminary assessment of the merits of the case, that the proceeding is neither frivolous nor vexatious, i.e. that there would be some possibility of success at trial. If there is a serious issue to be tried, then the judge proceeds to consider the other parts of the test, which are irreparable harm and balance of convenience. As the Supreme Court of Canada stated in *R.J.R MacDonald*, this is so even if the judge is of the opinion that the franchisor is unlikely to succeed at trial. Accordingly, when applying the "serious issue" threshold, courts have typically not delved into the ultimate enforceability of either restrictive covenants in particular or franchise agreements in general, leaving more careful and detailed scrutiny of the merits of the case as a matter for the trial judge.[5]

However, recent developments suggest that where a case involves the enforcement of a restrictive covenant, courts may be moving away from the relatively lower "serious issue"

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[4] See for example *674834 Ontario Ltd. (c.o.b. Coffee Delight) v. Culligan of Canada Ltd.* (2007), 28 B.L.R. (4th) 281 (Ont. Sup. Ct.) [*Culligan*] (a decision in which the author's firm was counsel for the franchisor); *Allegra of North America Inc. v. Wayne Zapfe et al*, unreported (2001) (Ont. Sup. Ct.), leave to appeal denied, *Allegra of North America Inc. v. Zapfe* [2001] O.J. No. 5412 (Ont. Sup. Ct.) [*Allegra I*]; *Ontario Duct Cleaning v. Wiles et al*, [2001] O.J. No. 5150 (Ont. Sup. Ct.) [*Ontario Duct Cleaning*], (a decision in which the author's firm was counsel for the franchisor); and *CashMoney Express Inc. v. 1035216 Ontario Inc.*, unreported (2003) (Ont. Sup. Ct.) [*CashMoney*].

[5] See for example, *Allegra I, Ontario Duct Cleaning* and *CashMoney, supra* note 4. In granting the injunctions in these cases, the court found that there was at least a serious issue to be tried as to the clauses' enforceability.

threshold, in favour of applying a more stringent test of "strong *prima facie* case".[6] To meet this higher threshold, a party seeking an interlocutory injunction must establish that "it is clearly right and that there is a high degree of assurance" of success of obtaining a permanent injunction at trial.[7] When applying this higher standard, the court will carefully examine the text and context of the franchise agreement and consider the enforceability of particular covenants within the agreement.[8] Closer scrutiny of the *ultimate enforceability* of the non-competition covenant(s) at issue appears therefore to be a key feature of this judicial movement towards the more rigorous "strong *prima facie* test" standard.

For example, in *Second Cup Ltd. v. Niranjan* ("*Second Cup*"),[9] the court scrutinized the post-termination non-competition clause contained in a franchise agreement which had only been signed by the franchisee in spite of the franchisor having expressly required execution of all documents by all of the parties. The court found that the non-competition clause was unenforceable on the basis that there was "nothing in the conduct of the parties which would suggest that they clearly assented to the precise terms of section 12 [the non-competition clause] of the franchise agreement".[10] Although the franchisee admitted that some obligations were owed to the franchisor upon termination, she was unclear as to the precise terms. As a result, the court stated that "…the evidence is not sufficient to show that parties are bound by the non-competition covenant, and, accordingly, Second Cup has not made out a strong *prima facie* case".[11]

Why the strong *prima facie* case test and not the serious issue to be tried standard? Justice Lederman explained that some circumstances "call for a stricter standard".[12] In *Second Cup*, the circumstances were that the granting of an interlocutory injunction would lead to the final determination of the issues at hand as the 15-month non-competition period would, in the court's view, be completed before the trial would ever take place.[13] In addition, the court relied on the

[6] This higher threshold of strong *prima facie* case has typically been applied to the enforcement of restrictive covenants in the employment context, where enjoining an individual would have severe consequences of loss of livelihood and chosen vocation. See comments of Justice Nordheimer in *Jet Print Inc v. Cohen*, [1999] O.J. No. 2864 (Ont. Sup. Ct.).

[7] *Culligan, supra* note 4 at para. 26.

[8] See *Lombardo v. Ragno*, [2001] O.J. No. 1300 (Ont. Sup. Ct.) [*Lombardo*] and *Second Cup Ltd. v. Niranjan*, 2007 CarswellOnt 5285 (Ont. Sup. Ct. [Commercial]) [*Second Cup*] (a decision in which the authors' firm was counsel for the franchisor).

[9] *Second Cup, supra* note 8.

[10] *Ibid.* at para. 19.

[11] *Ibid.* at paras. 26-27.

[12] *Ibid.* at para. 22.

[13] Presumably the court could have ordered an expedited trial like it did in the *Hyundai* case, at note 19, *infra*. In *Second Cup*, the franchise agreement expired on May 30, 2007 and the non-competition covenant was for fifteen months. There was ample time for a trial to be scheduled prior to the expiry of the non-competition covenant, especially since the matter was on the Commercial List.

fact that the franchisor was seeking to enforce a restrictive covenant.[14] For this proposition, the court referred to *Lombardo v. Ragno* ("*Lombardo*"),[15] a 2001 decision of the Ontario Superior Court of Justice. Importantly, *Lombardo* was not a franchise case, but rather involved a non-competition covenant contained in a shareholder agreement. In *Lombardo*, the court took issue with the plaintiff's interpretation of the non-competition clause. Specifically, the court found that the plaintiffs were "seeking to enforce a negative obligation that would severely and substantially impair the rights of the defendants to make their living".[16] The court determined that in circumstances where the rights of a party to make their living in their business would be substantially impaired by granting an interlocutory injunction, the "more stringent aspect of strong *prima facie* case is apt".[17]

A similar analysis was applied in *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp*. ("*Quizno's*").[18] Quizno's sought to enjoin three of its franchisees from breaching post-termination provisions of their franchise agreements, including the continued operation of submarine restaurants at their existing locations. The franchisees sought to restrain Quizno's from terminating their franchise agreements pending determination of Quizno's action for the franchisees' breach of contract.

Justice Perell determined that the franchisor was seeking a mandatory injunction to enforce a restrictive covenant which would restrain the franchisees' ability to make a living and applied the strong *prima facie* case standard.[19] Conversely, His Honour applied the lower serious issue standard to the franchisees' claim for injunctive relief because "enjoining Quizno's from terminating the franchise agreement would be a restrictive injunction and not a mandatory injunction."[20] Ultimately, the court held that Quizno's had demonstrated a strong *prima facie* case with respect to the franchisees' alleged breaches of the franchise agreement and granted Quizno's injunctive relief. The franchisees' injunction was denied.

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[14] See franchise cases referred to in note 4, *supra*, where a non-competition covenant was enforced and only the serious issue standard was applied. Even though the injunction was denied in *Allegra II*, the court applied the serious issue standard. See also *W.A.B. Bakery Franchising Ltd. v. Canam Advertising Ltd. and Raphi Shram*, (2007) CarswellOnt 8989 (Ont. Sup. Ct.) [*W.A.B. Bakery*], at note *28, infra*. *1460904 Ontario Inc. v. MDG Computers Canada Inc.*, [2006] CarswellOnt 6744 (Ont. Sup. Ct.) [*MDG Computers*] is another example of a franchisor being held to the strong *prima facie* case standard. However, the primary focus in that case was on the franchisor's request for a mandatory injunction requiring the franchisee to assign a lease, as opposed to the franchisor's request to compel the franchisee to comply with a post-termination non-competition covenant. See also *Quizno's*, below, where the franchisor sought injunctive relief to enforce a restrictive covenant and the court applied the strong *prima facie* case standard.

[15] *Lombardo*, *supra* note 8.

[16] *Ibid.* at para. 16.

[17] *Ibid.*

[18] *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, [2009] O.J. No. 1743 (Ont. Sup. Ct.) [*Quizno's*]

[19] Unlike in *Second Cup*, however, the court in *Quizno's* did not express concern with respect to the ultimate enforceability of the post-termination obligations contained in the franchise agreement.

[20] *Quizno's*, *supra* note 18 at para. 43.

Whether the "serious issue to be tried" test or "strong *prima facie* case" threshold is applied by the court appears also to largely be influenced by the practical effect of enforcing the covenant at issue. Where enforcing a restrictive covenant will impose an obligation on a party to act positively, it is viewed as a mandatory injunction and the plaintiff will have to meet the higher threshold of demonstrating that it has a strong *prima facie* case.[21] On the other hand, courts are more inclined to apply the lower serious issue to be tried threshold where enforcing a restrictive covenant does not substantially alter the *status quo*, and does not create an obligation, but rather holds parties to their existing obligations.

The distinction between prohibitive and mandatory interlocutory remedies in the context of terminating a franchise agreement was considered in *Struik v. Dixie Lee Food Systems Ltd.* ("*Struik*").[22] The franchise agreement at issue did permit termination without prior notice where the franchisee fail[ed] "to actively and continuously operate the business…up to the standards and reasonable expectations of the Franchisee", and thirteen more years remained in the term of the franchise agreement.[23] Justice Whalen found that although the franchisee's case met the higher standard required for a mandatory interlocutory injunction, in the circumstances of the case, where the franchisee sought simply to continue the rights agreed to under the franchise agreement and maintain the *status quo*, the relief sought by the franchisee was not mandatory in nature.[24] Justice Whalen stated that "it is a question of prohibiting termination of pre-existing rights, rather than requiring Dixie to do or not do something it had not already agreed to".[25]

It is clear from the foregoing that franchisors will arguably have greater success with meeting the first threshold of the Three-part Test if they can demonstrate the express terms of the restrictive covenant, and specifically that it relates to an *existing* or *on-going obligation*, rather than creating a new obligation.

Conversely, where a franchisee seeks to enjoin a franchisor from wrongfully terminating a franchise agreement pending trial, courts appear to be more inclined to apply the lower threshold of "serious issue to be tried". In *Culligan*, for example, the court held that there was an existing agreement between the parties (even though it had been terminated by Culligan on notice and the distributor had only come to court after the effective termination date), and the plaintiff distributor was therefore seeking to continue its rights under that agreement until trial. Finding that the plaintiff distributor's case was not frivolous or vexatious, and characterizing the

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[21] See for example *Culligan, supra* note 4, and *MDG Computers, supra* note 14.

[22] *Struik v. Dixie Lee Food Systems Ltd.*, [2006] O.J. No. 3269 (Ont. Sup. Ct.) [*Struik*]

[23] *Ibid.* at paras. 20 and 76.

[24] *Ibid.* at paras. 64 and 72.

[25] *Ibid.* at para. 72. See also *Erinwood Ford Sales Ltd. v. Ford Motor Co. of Canada*, [2005] O.J. No. 1970 (Ont. Sup. Ct.) [*Erinwood*], in which the court distinguished between mandatory and prohibitive injunctive relief. In *Erinwood*, Justice Spies wrote: "I agree with the observation of the Divisional Court in the TDL Group decision, that, distinguishing between positive and negative orders is not always clear-cut. It is somewhat like the old question of "is the glass half empty or half full?" Notwithstanding that it can be argued that there is a mandatory nature to the order sought by the plaintiffs, in that it requires the defendant to continue to comply with the terms of the Dealership Agreement, there is no question that granting the injunction creates no new rights. The plaintiffs seek to preserve the status quo pending trial and in my view, as a result, the order sought is not a mandatory injunction."

injunction as prohibitive, the court applied the lower "serious issue to be tried" threshold. More recently, in *1318214 Ontario Ltd. v. Sobeys Capital Inc. et al.* ("*Sobeys*"),[26] a case in which franchisees moved to restrain the franchisor from terminating the group's franchise agreements, the court only required the franchisees to satisfy the "serious issue to be tried" standard and ultimately granted them injunctive relief. Interestingly, unlike in *Culligan*, the court in *Sobeys* did not even consider the possibility that the "strong *prima facie* case" standard should apply in this context.[27]

Ontario Ltd. v. Hyundai ("*Hyundai*")[28] is a more recent example of an attempt by a franchisee to enjoin a franchisor from terminating the dealer agreement between the parties. In *Hyundai*, the court considered the appropriate test to be applied on an interlocutory injunction motion. The franchisor, like the franchisor in *Culligan*, argued that the franchisee's case should be measured against the higher standard of strong *prima facie* case because the relief sought by the franchisee dealer was mandatory, rather than prohibitive in nature and would require the franchisor to allow a terminated dealer agreement to continue. The court considered previous cases where courts had examined whether the dealership agreement contained renewal rights as a factor in determining whether an injunction would be prohibitive or mandatory, and the appropriate standard to be applied. The court noted that in cases where a right of renewal exists, requests for injunctive relief have typically been viewed as prohibitive because the plaintiff seeks to prevent the denial of a right already existing or agreed upon. On the other hand, where no renewal rights existed, injunctive relief was characterized as mandatory relief because it involved creation of a right or requiring the defendant to do something it had not previously contracted for or agreed to. The dealership agreement in *Hyundai* contained an annual automatic renewal clause. Accordingly, the court found that the applicable standard was "serious issue to be tried", as the essence of the injunctive relief sought was to preserve until trial the *status quo* of the dealership relationship, rather than create a new obligation to be imposed on the defendant.

Conversely, in another recent decision, *Hamburg Honda v. Honda Canada Inc.* ("*Hamburg Honda*"),[29] Justice Ramsay sitting in Welland, Ontario denied injunctive relief to the moving franchisees. In that case, the franchisor did not attempt to terminate the franchise agreement of a franchisee who would otherwise have the right to continue or renew, but exercised its right to give 180 days' notice to the franchisee that the franchise agreement would not be renewed after its expiry. Unlike *Hyundai*, no right of renewal existed in the franchise agreement. On that basis, Justice Ramsay found that the applicable standard was "strong *prima facie* case" because the injunction sought by the franchisees was mandatory and not prohibitive in that the status quo was the expiry of the franchise agreements at the end of their terms. The court held: "Neither party has any reasonable expectation of a renewed term. The relief sought would amount to the creation of a new right that does not exist in the contract."[30]

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[26] *1318214 Ontario Ltd. v. Sobeys Capital Inc. et al.*, 2010 ONSC 4141 [*Sobeys*].

[27] *Ibid.* at paras 15-31.

[28] *1323257 Ontario Ltd. (c.o.b. Hyundai of Thornhill) v. Hyundai Auto Canada Corp.*, [2009] O.J. No. 95 (Ont. Sup. Ct.).

[29] *Hamburg Honda v. Honda Canada Inc.*, [2009] O.J. No. 5152 (Ont. Sup. Ct.) [*Hamburg Honda*].

[30] *Ibid.* at para 13.

Most recently, in *C.M. Takacs Holdings Corp. v. 122164 Ontario Ltd. et al.* ("*C.M. Takacs*"),[31] the court cited the decision in *Struik* (as well as *Culligan*) in support of its finding that the franchisees seeking injunctive relief should be held to the lower standard of "serious issue to be tried".[32] In *C.M. Takacs*, the franchisees sought to require the franchisor to return possession of four franchise locations which it had assumed after terminating the respective franchise agreements; account for all profits which it had received since taking possession; and deliver all gross revenues to the franchisees. The franchisor argued that these amounted to positive actions which would render the injunction mandatory and as such should require the franchisees to satisfy the higher standard. The court disagreed, holding:

> Although the relief sought by the plaintiffs requires the defendant to reinstate the franchises, a positive action, the reality is that, as was the case in *TDL Group Ltd. v. 1060284 Ontario Limited*, [2001] O.J. No. 3614 (Div. Ct.), the plaintiffs are seeking an order prohibiting what they allege to be a breach of contract. As observed by the Divisional Court in TDL at para. 9, "an order preventing the denial of a right previously agreed to is very different from an order establishing a new right never agreed to and requiring a party to act accordingly.[33]

Despite applying the very low "serious issue to be tried standard", the court found that the franchisees did not meet it on the basis that their assertion that the franchisor had breached their franchise agreements and terminated the franchises was not factually correct. Indeed, the franchisees had acknowledged that since March 2007, they had not paid rent, franchise fees and some other creditors on a timely basis. Further, in May 2010, the plaintiffs had presented a cheque to the defendant to pay franchise fees, which was returned N.S.F. On these facts, the court was not prepared to find that as a "serious issue to be tried" the franchisor had acted unfairly or in bad faith or commercially unreasonably in enforcing the terms of the franchise agreements.

The approach taken by the court in *C.M. Takacs* stands in sharp contrast to the approach adopted in *Bark & Fitz Inc. v. 2139138 Ontario Inc.* ("*Bark & Fitz*"),[34] a decision which was released prior to *C.M. Takacs*. Unlike the majority of wrongful franchise termination cases in which it is the franchisee seeking to restrain the franchisor from terminating the franchise agreement, it was the *franchisor* in *Bark & Fitz* which was seeking to restrain its *franchisees* from terminating their agreements. The franchisor argued, as franchisees tend to successfully argue in wrongful termination cases, that it was seeking to enjoin the franchisees from breaching their franchise agreements. In this case, however, the court was not persuaded that the order sought was prohibitive. Rather, the court characterized the actions which the franchisor sought to compel not as preventing the breach of contract like in *C.M. Takacs* but as positive actions to repair a broken relationship. The court considered both "the restorative nature of the order" and "the positive actions required to comply"[35] and held: "for the most part, this may very well be a mandatory

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[31] *C.M. Takacs Holdings Corp. v. 122164 Ontario Ltd. et al. (c.o.b. New York Fries)*, 2010 ONSC 3817 [*C.M. Takacs*].

[32] *Ibid.* at para 30.

[33] *Ibid.*

[34] *Bark & Fitz Inc. v. 2139138 Ontario Inc.*, 2010 ONSC 1793 [*Bark & Fitz*] (a decision in which the author was counsel for the franchisor on the interim injunction].

[35] *Ibid.* at para. 9.

injunction."[36] Ultimately, however, Bark & Fitz met both the higher "*prima facie*" and "serious issue" standards and the injunction was granted.

Interestingly, the court in *C.M. Takacs* considered and attempted to distinguish the holding in *Bark & Fitz*. The court explained that while *Bark & Fitz*, which held the franchisor to the higher "strong *prima facie* case" standard, did not depend upon a determination of the parties' right to continue a relationship (but rather the restoration of a broken relationship), the outcome in *C.M Takacs* (like in *Culligan* and *Struik*) did rest upon such a determination and meant therefore that the order sought was prohibitive and not mandatory and should only require the franchisee to meet the "serious issue to be tried" standard.[37] Another unacknowledged but unavoidable distinction between these cases was the identity of the party moving for injunctive relief. In *Culligan, Struik* and *C.M. Takacs*, it was a franchisee seeking to restrain a franchisor from terminating the franchise agreement, and the court characterized these cases as prohibitive injunctions. In *Bark & Fitz*, however, it was the franchisor seeking to restrain a group of franchisees from breaching the agreement, and this was characterized as a positive injunction.

The analyses in *Second Cup*, *Quizno's*, *Hyundai*, *Culligan* and *Struik* suggest that Ontario courts may apply greater scrutiny to the merits of cases where a franchisor seeks to enjoin a franchisee from breach of a restrictive covenant than where a franchisee seeks to enjoin a franchisor from terminating an agreement pending trial. Indeed, while a franchisee need only demonstrate that his case is not frivolous or vexatious, a franchisor who wishes to enforce a restrictive covenant may have to show a high degree of assurance of success at trial. Moreover, the analyses in *Bark & Fitz* and *C.M. Takacs* suggest that Ontario courts will apply greater scrutiny to the merits of cases where franchisors seek to enjoin a franchisor from terminating an agreement than when it is the franchisee who seeks to enjoin a franchisor from terminating an agreement. Interestingly, while courts are inclined to characterize enforcement of a restrictive covenant against a franchisee as a mandatory injunction, mandating the higher "strong *prima facie* case" threshold, requiring a franchisor to continue a terminated franchise agreement or relationship is not viewed as imposing a positive obligation.[38] However, requiring a franchisor to continue such a relationship is arguably imposing a positive obligation upon it where that franchisor has a right to terminate the relationship under the franchise agreement.[39]

Courts have held that "categories of positive and negative covenants and orders are not clear-cut" and that whether the particular relief sought is prohibitive or mandatory in nature is determined by its "factual matrix".[40] It appears, therefore, that franchisors may have greater success in obtaining injunctions to enforce a restrictive covenant if they are able to frame the injunction as prohibitive, in accordance with an unequivocal and existing agreement, rather than mandatory.

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[36] *Ibid.*

[37] *C.M. Takacs, supra* note 27 at para 30.

[38] See *Quizno's, supra*.

[39] For example, in *Quizno's*, had the court granted the franchisees injunctive relief, doing so arguably would have imposed a positive obligation on Quizno's to continue its agreements with the franchisees in spite of clear breaches of the agreements and Quizno's contractual right to terminate the relationships.

[40] *TDL Group Ltd. v. 1060284 Ontario Ltd.*, [2001] O.J. No 3614 (Ont. Sup. Ct. [Divisional Court]) at para. 4; *Culligan, supra* note 4 at para. 33; *Erinwood, supra* note 23 at 72.

Similarly, where a franchisee seeks to enjoin the termination of a franchise agreement, a franchisor challenging that injunction might have resort to the higher standard of strong *prima facie* case if continuance of the agreement can be persuasively characterized as imposition of a positive obligation upon the franchisor.

SECOND TREND: GREATER EVIDENTIARY BURDEN FOR DEMONSTRATING IRREPARABLE HARM

The movement towards a higher standard for assessing the strength of the plaintiff's case on an interlocutory injunction motion also appears to be coupled with more rigorous evidentiary requirements for demonstrating irreparable harm,[41] the second element of the Three-part Test.

In the past, courts have accepted arguments from counsel that a franchisee or former franchisee's breach of a restrictive covenant causes damage to the franchise system generally, and therefore satisfies the second criteria of the Three-part Test: irreparable harm. In *Allegra of North America Inc. v. Wayne Zapfe et al* ("*Allegra I*"), the court found that damages alone would not be an adequate remedy, and emphasized the importance of maintaining the integrity of the franchise business. Specifically, the court stated that if franchisees are permitted to carry on a "shadow business", "the character of franchisor's business will be changed. It will be carrying on a training business, not a franchise business. The core of the franchise system will be destroyed."[42]

Courts have also traditionally considered breaches of restrictive covenants of franchisees to constitute irreparable harm because of the potential for such breaches to encourage other franchisees of that franchisor to learn from example and similarly breach a non-competition covenant.[43]

However, recent decisions suggest a growing reluctance of courts to accept principles of general harm to the franchise system, or arguments that breach by one (former) franchisee will encourage a domino effect of breaches by other franchisees, in the absence of actual evidence of such harm. Indeed, courts are increasingly requiring plaintiffs to meet a higher evidentiary burden of demonstrating specific examples of irreparable harm.

For example, in *W.A.B Bakery*,[44] the franchisor (What A Bagel) argued that the integrity of its franchise system would be undermined if a non-competition covenant was not enforced because the conduct of the former franchisee would encourage other franchisees to breach their own non-competition covenants when their franchise agreements expired. What A Bagel further argued that failure to enforce the non-competition covenant would result in the reluctance of prospective

[41] Irreparable harm is defined as harm that cannot be readily compensated for in damages, and refers to the unquantifiable nature of the harm suffered, rather than its magnitude. *R.J.R. MacDonald Inc.*, *supra* note 2.

[42] *Allegra I*, *supra* note 4. See also *Ontario Duct Cleaning* and *CashMoney*, *supra* note 4, in which the court stated: "A decision to allow a person whose franchise agreement has been terminated to commence a similar business in a franchised area would have an impact on all franchise systems".

[43] See for example *CashMoney*, *supra* note 4: "If [the defendant] can continue to operate a similar business from the same premises or within the franchised area it could jeopardize the Canadian Franchise system because other Cashplan franchisees may do so the same as the defendant has done".

[44] *W.A.B. Bakery, supra* note 14.

What A Bagel franchisees to enter into franchise agreements for new locations. Additionally, What A Bagel argued that it would suffer a loss of goodwill if the products served by the former franchisee in its new business did not meet the quality of products served at other What A Bagel franchises. The court agreed that What A Bagel would suffer irreparable harm if similar action were taken by other franchisees in the future, but rejected What A Bagel's arguments on account of its failure to provide evidence of such action being taken or threatened at the time of the application or in the future. Furthermore, there was no evidence of prospective franchisees deciding not to enter into franchise agreements for new locations as a result of the former franchisee's actions.

Further, in *Second Cup,* the court rejected the franchisor's argument that it would suffer irreparable harm if the franchisee was allowed to continue its newly established coffee operation, as this would send a message that Second Cup franchises can be used as a training ground to open up competing retail coffee enterprises, thus compromising the integrity of the Second Cup franchise system. The court found that there were significant differences between the business models of Second Cup and its former franchisee, specifically that the coffee and tea sold by the former franchisee's new café was fair trade and organically grown, while this was not the case at Second Cup cafés. The court held that because of this distinction between the two operations, there had not "been any significant adverse effect to the integrity of Second Cup's franchise system".[45] Further, any damages suffered by Second Cup in lost customers could be calculated as money damages.

In *Allegra of North America and Allegra Corporation of Canada v. Russell Sugimura et al ("Allegra II*"),[46] the court rejected the franchisor's argument that irreparable harm would result from breach of a non-competition covenant because other franchisees would feel at liberty to disregard their non-competition covenants. In its decision, the court noted that Allegra's assertion of irreparable harm was "not based on any irreparable harm flowing from the breach of the Franchise and License Agreement with the defendants", indicating that in order to demonstrate irreparable harm, a franchisor must give <u>specific evidence</u> of irreparable harm flowing from the breach at issue, rather than potential future harm. Importantly, the court in *Allegra II* found that in seeking to enjoin its former employee, the franchisor had no legitimate business interest to protect in the geographic area in which the former franchisee was employed (on account of there being no franchise in the area), and that there was no evidence that the franchisor intended to establish or maintain a franchise in that geographic area after the expiry of the franchise agreement. As a result, the court held that the non-competition covenant was unenforceable. To enforce it in the circumstances would serve no valid purpose as it was not reasonably required for the franchisor's protection.[47] Interestingly, in *Allegra II,* the court

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[45] *Second Cup*, *supra* note 8 at paras. 29-31.

[46] *Allegra of North America and Allegra Corporation of Canada v. Russell Sugimura et al.*, (2008) (unreported) Court File No. CV-08-21790-00 (Ont. Sup. Ct.) [*Allegra II*]. The case involved an application for an interlocutory injunction to restrain former franchisees from carrying on a printing business at the same location where an Allegra franchise was operated for many years. Allegra alleged that the former franchisees violated their post-expiration non-competition covenant because one of the former franchisees was employed by a new printing/copying business operating out of the same location as the former Allegra location. Dismissing the franchisor's application, the court held that the franchisor failed to demonstrate that irreparable harm would result from failure to grant injunctive relief.

[47] *Allegra II*, *supra* note 34 at para. 22.

applied the lower "serious issue to be tried" threshold, and found that although there was a serious issue to be tried as to the *enforceability* of the non-competition covenant, the absence of any sustainable claim for damages or irreparable harm flowing from breach of the covenant meant that the threshold was not met.

In *Quizno's*, both the franchisor and franchisees provided affidavit evidence of irreparable harm to support their respective requests for injunctive relief. However, to satisfy itself that the franchisees would suffer irreparable harm unless they were granted an interlocutory injunction, the court appeared to rely on the general proposition that "the termination of a franchise, the loss of reputation and the loss of goodwill may constitute irreparable harm"[48] rather than the franchisees' actual evidence of irreparable harm. Justice Perell's comments with respect to the irreparable harm suffered by Quizno's suggests that a substantially higher test for irreparable harm applies to franchisors and requires evidence of harm on a larger scale or across the franchise system generally.[49] On appeal, Justice Carnwath rejected the franchisees' submission that Justice Perell's conclusion on the irreparable harm to Quizno's was based on evidence that didn't exist. Justice Carnwath held that the affidavit evidence and jurisprudence respecting "the importance of protecting the trademarks and systems of the franchisor, for its benefit and for the benefit of the franchisees" was sufficient evidence of irreparable harm.[50]

The decisions in *Allegra II*, *W.A.B. Bakery*, *Second Cup* and *Quizno's* place an elevated burden on franchisors to demonstrate irreparable harm that goes beyond general threats to the integrity of the franchise system or compromised goodwill. These cases suggest that when seeking an interlocutory injunction to enforce a post-termination restrictive covenant, a franchisor should be prepared to provide concrete evidence demonstrating it has a legitimate business interest to protect, in the form of an actual or planned franchise.

In *Bark & Fitz*, the court, as discussed above, granted injunctive relief to the franchisor. Unlike in *Allegra II* and *Quizno's*, the court did not require the franchisor to adduce specific evidence of irreparable harm in order to satisfy the criterion. Rather, the court relied upon an inference to support its conclusion.[51] On this basis, the approach taken in *Bark & Fitz* appears to resemble the one taken in *Allegra I* and some of the older jurisprudence. Upon closer examination, however, the approach taken by the court in *Bark & Fitz* is in fact distinguishable. While it is true that Bark & Fitz was not required to adduce specific evidence, this was not because the court accepted a general proposition of the sort accepted in *Allegra I* and earlier cases. To the contrary, the court focused on facts specific to the *Bark & Fitz* case, namely that Bark & Fitz maintained a relatively small franchise system, comprising only 20 franchisees; and that 17 of these franchisees (each of whom was a named defendant) had refused to pay royalty fees under

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[48] Quizno's, *supra* note 18 at para. 95.

[49] *Ibid.* at paras. 99 and 104. The court in *Quizno's* specifically observed the following with respect to the irreparable harm suffered by the franchisor: "A zero-tolerance to perhaps inadvertent or only occasional harm caused by breach of a franchise agreement by an individual franchisee or small number of franchisees in a national franchise chain sets the bar much too low for irreparable harm and balance of convenience." However, where a dispute is not "localized" but affects a franchisor's management rights across the chain of franchises" this influences the calculus of irreparable harm and the balance of convenience."

[50] *Quizno's Canada Restaurant Corp. v. 1450987 Ontario Corp.*, 2009 CarswellOnt 3455 at para. 2.

[51] *Bark & Fitz*, *supra* note 30 at paras 30-34.

the agreement, representing a loss of approximately 45% of annual revenue to Bark & Fitz. The court characterized it as an "inescapable inference"[52] that the Bark & Fitz franchise system would not survive until a decision was reached at trial in the absence of that revenue stream. In other words, while it is true that the franchisor was not required to adduce evidence, *per se*, it is clear that something more (in this case the fact that the vast majority of the franchisees were involved) than the general argument raised in *Allegra I*, was required to satisfy the irreparable harm criterion.

When it comes to franchisees seeking injunctive relief, it appears that courts will not always apply the same scrutiny to evidence of irreparable harm adduced by franchisees. In *Culligan*, the defendants took issue with the plaintiff distributor's statement that 90% of its sales were in respect of the defendant's bottled water, and that if it was unable to supply this water it would go out of business. These statements were not substantiated by evidence as to either volume of sales or lack of alternative suppliers of water. Although the court agreed that bald statements are not sufficient to establish irreparable harm, it did not scrutinize the plaintiff's statements. Rather, viewed in the context of the plaintiff being a small company, and its "significant reliance" on sales of the defendant's bottled water, the court did not find the plaintiff's assertions of irreparable harm to be "bald statements".[53]

In *Struik*, the franchisor argued that the franchisee did not discharge his evidentiary burden in demonstrating irreparable harm.[54] Finding that the termination of the franchise agreement had indeed caused the franchisee to suffer irreparable harm, Justice Whalen observed that although the franchisee's age was not stated, he was "obviously a man of at least 60 years" and had "therefore devoted the better part of his working life to [the] franchise…the issue is the loss of long-established means to pursue a rewarding livelihood, not proving financial hardship or destitution".[55] Further, His Honour wrote that "although not much was made of [the franchisee's relationship with other franchisees] in argument, I am convinced there is probably a proprietary and goodwill aspect to JS's status as an area franchisee", and that quantification of the proprietary aspects of JS's interest in the Area Franchise Agreement would be difficult.[56]

Finally, in *Sobeys* the court found that the franchisees satisfied the irreparable harm criterion on similar bases. The franchisees sought to enjoin the franchisor from terminating the franchise agreement and re-possessing the locations pending trial. The franchisor argued that there was no evidence from the franchisees' accountant that the damages could not be quantified in monetary terms. Further, the franchisor submitted that any harm sustained by the franchisees could be compensated with damages given that it would continue to operate the stores in question and that it would waive the non-competition clause in the agreement if it were unsuccessful at trial. The court disagreed:

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[52] *Ibid.* at para 33.

[53] *Culligan, supra* note 4 at paras. 42 and 43.

[54] *Struik, supra* note 20 at para 67.

[55] *Ibid.* at para. 73.

[56] *Ibid.* at paras. 75 and 76.

> If the injunction is not granted, the remaining four Franchisees will lose their businesses. Regardless of whether Sobeys continues to operate the stores, those Franchisees will lose the business that they had purchased, that they were operating, that their families worked in and that they expected to develop over the term of the franchise. That opportunity cannot be restored to them with a payment of monetary damages.[57]

Here, as in *Struik*, the court appears to have been persuaded by the human element of the franchisee's story, as is evident by its focus on the familial aspect of the business. The court held that regardless of whether Sobeys continued to operate the stores, the franchisees would lose the business that they had purchased, that they were operating, that their families worked in and that they had expected to develop over the term of the franchise. According to the court, that opportunity could not be restored to them with a payment of monetary damages. Even if the franchisees became employees of another store and earned an income that way, that change was not compensable in damages.

There are recent instances, however, in which courts have held franchisees to a higher standard. In *C.M. Takacs*, for example, the court considered an argument substantially similar to one raised by the franchisor in *Sobeys* – the fact that it (the franchisor) would continue to operate the locations in question, pending a decision at trial, suggested that any damages sustained in the interim could be remedied with damages. Unlike in *Sobeys*, the court accepted this argument in *C.M. Takacs*, holding that the irreparable harm standard was not met. The court reasoned that because the change in control of the locations (from franchisee to franchisor) would be essentially invisible to the customer, no goodwill would be lost.[58] Further, any and all profits from each of the franchise locations would be easily traceable and accountable. Unlike *Sobeys*, however, there was no issue in *C.M. Takacs* that the franchisor was breaching any of its statutory obligations under the *Arthur Wishart Act*. Rather, the court stated that it was clear from the materials that the franchisees' difficulties had resulted from their cash flow problems which the franchisor had nothing to do with.

Similarly, in *Hamburg Honda*, the court held that the moving franchisee did not meet the irreparable harm standard. The franchisee operated two Honda franchises, and argued that he would be forced to close one of the two locations if the relief were not granted, causing irreparable harm to his business. A highly relevant factor for the court appears to have been that the franchisee's other location would remain open during trial and for some time thereafter. The court reasoned that potential customers of the closed dealership would be able to attend the remaining location (which was located nearby) and that the franchisee would not be therefore be forced out of business. The court further held that any lost employee jobs were not the franchisee's loss and that any resulting loss of goodwill was a commodity that could be quantified and therefore compensated at trial.[59] Any loss of goodwill would be mitigated in any event by the fact that customers in the non-renewed location could buy cars from the franchisee at his other location.

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[57] *Sobeys, supra* note 22 at para 38.

[58] *C.M. Takacs, supra* note 27 at para 38.

[59] *Hamburg Honda, supra* note 25 at paras 11-12.

Struik and *Culligan* arguably suggest that in the context of wrongful franchise termination cases, franchisees seeking interlocutory relief will, in many circumstances, not face the same rigorous evidentiary hurdle faced by franchisors to demonstrate irreparable harm. *C.M. Takacs* and *Hamburg Honda* suggest that, in other circumstances, franchisees might be held to a comparable standard. Much appears to turn on the franchisee's ability to evoke sympathy in the presiding motion judge. In any case, a franchisor should be prepared for the possibility that a franchisee will be held to a lower standard.

THIRD TREND: AFFIRMATION OF THE THREE-PART TEST

Courts have affirmed that irreparable harm and balance of convenience are factors which must be considered in determining an interlocutory injunction, even where there is unequivocal evidence of breach of a restrictive or negative covenant. Previous decisions such as *Ontario Duct Cleaning Ltd*,[60] *CashMoney*,[61] and *Button v. Jones*[62] *and MBEC Communications Inc. v. Nagel*,[63] held that where there is clear breach of a restrictive covenant, the first element of the Three-part Test is satisfied and the additional elements of irreparable harm and balance of convenience need not be addressed.

In *Allegra II*, the court stated that while less emphasis should be placed on irreparable harm and balance of convenience in cases of clear breach of an express negative covenant, this "does not mean that there is no obligation to deal with these factors".[64] Similarly, in *Van Wagner Communications Co. v. Penex Metropolis Ltd*., the court considered case law involving clear breach of restrictive covenants where irreparable harm and balance of convenience were considered, and cases where these two factors were ignored. The court held that "even where there is a clear breach of a negative covenant which is reasonable on its face, the issues of irreparable harm and balance of convenience cannot be ignored". However, these factors may be given less weight in determining the issue "depending on the strength of the plaintiff's case".[65] Although *Van Wagner Communications* is not a franchise law case, but rather dealt with a breach of an exclusive sales agency agreement for outdoor advertising, it is relevant as a recent affirmation that irreparable harm and balance of convenience will continue to be weighed by courts on interlocutory injunction motions.[66]

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[60] *Ontario Duct Cleaning*, *supra* note 4.

[61] *CashMoney*, supra note 4.

[62] *Button v. Jones*, [2001] O.J. No. 1976 (Ont. Sup. Ct.).

[63] *MBEC Communications Inc. v. Nagel*, [2007] CarswellOnt 2042 (Ont. Sup. Ct.).

[64] *Allegra II*, *supra* note 29 at para. 30.

[65] *Van Wagner Communications Co. v. Penex Metropolis Ltd*., [2008] O.J. No. 190 (Ont. Sup. Ct.) [*Van Wagner Communications Co.*] at para. 39.

[66] The decision of Justice Patillo in *Van Wagner Communications Co*., *supra*, was upheld on appeal by the Ontario Divisional Court (see *Van Wagner Communications Co. v. Penex Metropolis Ltd*., [2008] O.J. No. 1707 (Ont. Sup. Ct. [Divisional Court]). Specifically, the Divisional Court affirmed that "Where a negative covenant is breached and a *prima facie* case is made out, regard must be had to irreparable harm and balance of convenience, but not to the same extent as where there is no negative covenant". The Divisional Court further

Interestingly, in *Quizno's*, the relative strengths of the parties' cases were considered both at the threshold stage of the Three-part test and when weighing the balance of convenience. Justice Perell determined that the franchisees' request for injunctive relief failed the balance of convenience test "especially when the comparative strength of their defence [was] compared with Quizno's strong *prima facie* case that there have been one or more branches of their franchise agreements".[67]

Conclusion

Recent trends in the law of interlocutory injunctions in the franchise context suggest some practical implications of which franchisors should be aware. Previously, it was rare for a franchisor to be unsuccessful on an interlocutory injunction motion for failure to meet the first element of the Three-part Test, as courts simply applied the low "serious issue to be tried" threshold. So long as a case was neither frivolous or vexatious, i.e. there was some possibility of success at trial, a plaintiff would easily satisfy the "serious issue to be tried" requirement. Now, when it is a matter of enforcing restrictive covenants, courts may be taking a harder look at the merits of the case at the interlocutory stage. As a result, when considering whether to pursue an interlocutory injunction, franchisors should consider the ultimate enforceability or strength of the restrictive covenant at issue, and whether the terms of the franchise agreement or termination agreement are unequivocal, before proceeding with an injunction.

Additionally, when pursuing an interlocutory injunction, a franchisor can no longer merely rely on persuasive arguments from prior cases with respect to compromised goodwill or general damage to the franchise system. Rather, the franchisor must be prepared to provide concrete evidence of actual irreparable harm suffered as a result of the breach of the restrictive covenant. If there are weaknesses on either of these fronts, a franchisor should tread cautiously when pursuing injunctive relief. Injunctions are extremely costly and like all motions, if a moving party is unsuccessful, then not only must it pay its own lawyer's costs but it will be required to pay some of the responding party's costs. To avoid paying any of the franchisee's costs, the franchisor will have to try to settle with the franchisee by either offering to drop any appeal from the order of the court dismissing the injunction and/or to not pursue any action against the franchisee in respect of its alleged breach of the non-competition covenant.

To avoid the Three-part Test altogether, parties may wish to consider seeking injunctive relief by way of application instead of by motion.[68] That way, the Three-part Test does not apply since

held that it "cannot be said that there are conflicting decisions on the point in Ontario". However, an appellate court has yet to clarify the appropriate threshold test, as discussed above, and what constitutes irreparable harm on an interlocutory injunction.

[67] *Quizno's*, *supra* note 18 at para. 96.

[68] Under Rule 14.05(3)(g) of the *Ontario Rules of Civil Procedure*, a proceeding may be brought by way of an application for an injunction, mandatory order . . . when ancillary to relief claimed in a proceeding properly commenced by a notice of application. In the case of an application to enforce a post-termination covenant, a franchisor should apply under Rule 14.05(3)(d) for a determination of rights that depend on the interpretation of a contract (in this case a franchise agreement) in addition to its application for an injunction to enforce the post-termination obligations under the franchise agreement. *W.A.B. Bakery Franchising, supra*, is an example of a franchisor commencing a proceeding to enforce a non-competition covenant by way of application. However, rather than seeking an injunction on a permanent basis, the franchisor sought an interlocutory injunction until the date of a decision by an arbitrator or the Court on the franchisor's request for a similar injunction on a

the injunction sought under an application is permanent (that is, until the covenant expires as opposed to until the trial is heard) and not interlocutory. Of course, the franchisor will still have to establish on a balance of probabilities that the covenant is enforceable and that it has been breached by the franchisee. Further, the franchisor will also have to establish that damages, the ordinary remedy for any breach of contract, are an inadequate remedy for any breach of the restrictive covenant and that franchisee's infringing conduct must therefore be enjoined.

Another option is for the franchisor at the commencement of the hearing of a motion for an injunction to ask for an expedited trial, well prior to the expiry of the restrictive covenant at issue. Obtaining an expedited trial date avoids the argument (raised in *Second Cup* and *Lombardo*) that the injunction will finally determine the matter. In the *Hyundai* case, in which an interlocutory injunction was granted in favour of the franchisee on January 13, 2009, the Court ordered an expedited two-week trial to commence no later than April 30, 2009, only a little over three months away.[69]

Although the Ontario Divisional Court in *Van Wagner Communications*, confirmed that all elements of the Three-part Test apply where there is a breach of a negative covenant, some uncertainty remains in the law of interlocutory injunctions in the franchise context. The apparent dichotomy between decisions in which courts have applied the thresholds of "serious issue to be tried" or "strong *prima facie case*", as well as conflicting case law with respect to the evidentiary standard for proving irreparable harm, suggest a need for clarification by an appellate court.

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permanent basis. As such, the Three-part Test applied. For the first part of the Three-part Test, the Court applied the serious issue to be tried test, even though what the Court was being asked to enforce was a restrictive covenant. In *Second Cup*, *supra*, the Court stated that the enforcement of a restrictive covenant required the higher standard of strong *prima facie* case.

[69] There will not be en expedited trial, however, as the case has settled.